Tax Alert

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AS PricewaterhouseCoopers in Estonia helps clients in finding tax efficient business solutions and managing tax risks.

We work together with our colleagues in other PricewaterhouseCoopers' offices world-wide and use our access to international know-how and long-term experience to quickly and efficiently solve tax issues that arise both locally and in foreign jurisdictions.

For more information, please see our contact details below.

TAX TREATIES

Tax treaty between Estonia and Serbia entered into force

On 24 September 2009 Estonia and Serbia signed the treaty for avoidance of double taxation with respect of taxes on income. The treaty came into force on 14 June 2010 and will be effective from 1 January 2011.

The treaty generally follows the wording of the OECD Model Tax Convention, which is the basis also for the rest of the Estonian tax treaties. The treaty provides for the following tax rates for taxing investment income:

- – Treaty limits withholding tax on dividends to 5% provided that the shareholder is a company holding directly at least 25% of the capital of the company paying the dividends and 10% in all other cases. As Estonian domestic legislation does not provide for a withholding tax on dividends, the treaty may generally affect only the dividends paid from Serbia to Estonia;
- Treaty limits withholding tax on interest to 10% and provides several exemptions (eg for interest payable to financial institutions wholly owned by government). As Estonian domestic legislation does not provide for a withholding tax on arm's length interest, the treaty may generally have an impact only on interest payable from Serbia to Estonia;
- Treaty limits withholding tax to 5% on royalties for the use of, or right to use any copyright of literary, artistic or scientific work including cinematographic films. Any other royalties, including payments for the use of, or right to use any industrial, commercial, and scientific equipment and computer software may be subject to withholding tax of 10%.

Text of the treaty is available at: https://www.riigiteataja.ee/ert/act.jsp?id=13252522

Tax treaty concluded between Estonia and Albania

On 5 April 2010 Estonia and Albania concluded the treaty for avoidance of double taxation with respect of taxes on income. The treaty generally follows the wording of the OECD Model Tax Convention, which is the basis also for the rest of Estonian tax treaties. The treaty provides for the following tax rates for taxing investment income:

- Treaty limits withholding tax on dividends to 5% provided that the shareholder is a company holding directly at least 10% of the capital of the company paying the dividends and 10% in all other cases. As Estonian domestic legislation does not provide for a withholding tax on dividends, the treaty may generally affect only the dividends paid from Albania to Estonia;
- Treaty limits withholding tax on interest to 5% and provides several exemptions (eg for interest payable to or loans guaranteed by financial institutions performing functions of governmental nature). As Estonian domestic legislation does not provide for a withholding tax on arm's length interest, the treaty may generally have an impact only on interest payable from Albania to Estonia;
- Treaty limits withholding tax to 5% on royalties.

The signed treaty is not yet in force. The

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treaty will enter into force after the parties have notified each other about the completion of the respective domestic constitutional procedures (e.g. ratification in Estonia). As a general rule, the treaty would become effective from January 1 of the year following that in which treaty enters into force.

The full text of the treaty in Estonian and English and the explanatory memorandum in Estonian are available at:
http://eoigus.just.ee/?act=6&subact=1&OTSIDOC_W=291014

LEGAL ACTS

Income Tax Act: Taxation of investment income received by individuals

On 3 June 2010 the Parliament adopted the amendments to the income tax act regulating the taxation of investment income received by individuals. The changes will enter into force as of 1 January 2011. Most significant changes are as follows:

- Individuals are entitled to create a separate investment account for tax purposes. Transferring certain securities and financial assets to such investment account would allow individuals to defer their tax liability on income or gains until the moment the income will be used in consumption. In other words, tax liability will only arise when funds withdrawn from the investment account exceed capital paid to the investment account;
- Tax exemption on savings interest will become more restricted. The exemption would not apply anymore to the savings interest that is related to value of the underlying assets. Exceptionally, tax exemption on such savings will be applicable to the amounts that are deposited before 1 January 2011 and interest is paid out before 31 December 2013;
- Tax exemption on payments made on account of the unit-linked life insurance contracts will be abolished. Exceptionally, the exemption will be applicable to the payments provided that contract is concluded before 1 August 2010 and profits are paid out no sooner than 12 years from the conclusion of the contract, but in any case before 31. December 2023.

Commercial Code: Converting share capital into Euros

On 22 April 2010 amendments to the Commercial Code were adopted which provide rules for private and public limited companies for converting their share capital into Euros. The amendments will enter into force on 1 July 2010.
On the 1st of July the Law amending Commercial Code and other laws enters into force which provides rules for private and public limited companies for converting their share capital into Euros. Companies will not have their share capital converted into Euros automatically with the official exchange rate but each company needs to take certain steps for converting the capital into Euros according to the prescribed rules. The more significant principles to keep in mind when arranging the conversion may be outlined as follows:

- The proportions of shareholders may not change in the course of the conversion;
- The new requirements regarding the nominal value of shares are 1 Euro per share for a private limited company and 10 Eurocents per share for a public limited company;
- Share capital of a private limited company must be a multiple of 1 Euro and share capital of a public limited company must be a multiple of 10 Eurocents;
- The new minimum required share capital is 2500 Euros for a private limited company and 25000 Euros for a public limited company.

Therefore it is likely that most companies will need to arrange for a reduction or increase of share capital to implement the conversion. This requires certain procedures to be completed at the Trade Register and the Articles of Association of the companies to be amended. As an innovation, the Commercial Code will allow the issue of shares without nominal value; this should facilitate the conversion of share capital for public limited companies. Shares without nominal value will only have an estimated value that is calculated by dividing the share capital with the number of total shares.
Conversion of share capital into Euros may be arranged starting from 1 July and in any case Euro share capital should be registered within one year from the day when Euro was taken into use. During the first year it will be possible to complete the procedures in a somewhat expedited manner without paying the state fee.

CASE LAW

Case 3-3-1-36-10: VAT treatment

On 16 June 2010 Administrative Chamber of the Supreme Court delivered a decision in the case no 3-3-1-36-10 dealing with the VAT treatment of certain supplies by the developer of real estate. The case was ruled in favor of the taxpayer. Taxpayer was a real estate developer, whose business was to develop and value plots of land with the purpose to sell those plots thereafter. To construct water supply and sewerage system, a personal right of use was granted to the local water undertaking. Establishing a personal right to use was not declared as a taxable supply by the taxpayer in 2007. Tax authorities found that establishment of personal right of use should have been subject to VAT as it cannot be compared to the establishment of usufruct and should

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therefore not be subject to VAT exemption under article 16 section 2 sub-section 2. Similarly, tax authorities found that free of charge transfer of communication structures by the taxpayer to the communications undertaking should have been subject to VAT in 2008 pursuant to article 12 section 4 of the VAT Act.

Based on the principle of substance over form, the Supreme Court found that in cases where the personal right to use is related to the possession there is no reasons to treat it differently from the establishment of usufruct and therefore the VAT exemptions provided in article 16 section 2 sub-section 2 should have also applied to personal right to use.

In respect of free of charge transfer of communication structures the Supreme Court found that by applying article 12 section 4 of the VAT Act the tax authorities were applying the rule that was incompatible with EU legislation. Incompatibility was created by the fact that Estonia had not implemented the amendments introduced by the directive 2006/69/EC timely i.e. by 1 January 2008 (Article 12 section 4 in VAT Act was brought in line with the Directive only as of 1 January 2009). According to the directive the tax authorities would not have been entitled to adjust the value of the transaction that was carried out between unrelated parties and the real estate developer in the case at issue was certainly not related to the communications undertaking. The Supreme Court emphasized that in case of an incompatibility of Estonian legislation with EU legislation, domestic legislation should be interpreted in the light of the EU legislation. If such interpretation is not possible, the directives should be directly applied.

OTHER USEFUL INFORMATION

Polish legal and tax alerts

Should you be interested in updates on legal and tax developments taking place in Poland, you may find the relevant tax and legal alerts from the link following site: http://www.taxonline.pl/

PwC was awarded as the best transfer pricing firm in the Baltic States

International Tax Review awarded PricewaterhouseCoopers as the Baltic Transfer Pricing Firm of the Year 2010. This year was the first time when the nominees from the Baltic States were invited to participate in this nomination. According to International Tax Review, the awards were mainly judged on the size, innovation and complexity of the issues that the firms were facing while servicing their clients. The prestigious magazine's editorial staff was consulting a large number of tax advisers, private-practice lawyers, tax executives and in-house counsel to gain their perspective on the ground-breaking work of the February 2009 to February 2010 period.

PricewaterhouseCoopers European transfer pricing network was also named as the European Transfer Pricing Firm of the Year for the second year in a row.

Our people

On 18 June 2010 Ain Veide published in portal "raamatupidaja.ee" an article "Käibemaks: Riigikohus tegi maksumaksja jaoks positiivse lahendi" ("VAT: Supreme Court decided to in the favour of the taxpayer"). Article (in Estonian) is available at:
http://www.raamatupidaja.ee/article/2010/06/18/Kaibemaks_Riigikohus_tegi_maksumaksja_jaoks_positiivse_lahendi.

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